

URUGUAY

MUNICIPAL DEVELOPMENT AND MANAGEMENT PROGRAM

(UR-0131)

LOAN PROPOSAL

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BASIC SOCIOECONOMIC DATA

For basic socioeconomic data, including public debt information, please refer to the following address:

<http://www.iadb.org/RES/index.cfm?fuseaction=externallinks.countrydata>

INFORMATION AVAILABLE IN THE RE1/SO1 TECHNICAL FILES

Preparation:

Cracel, Marcio. *Resultados de la ejecución de los componentes de fortalecimiento institucional del Programa de Obras Municipales (POM) II y PDM III en una muestra de departamentos y recomendaciones para el Programa de Desarrollo de la Gestión Municipal (PDGM) IV*. October 2002.

GPI Consultores. *Informe final de la consultoría para la Promoción de Desarrollo Económico Local en Uruguay*. May 2002.

Lebedinsky, Santiago. *Evaluación Expost del Programa de Desarrollo Municipal (PDM) III Uruguay*. October 2002.

López de La Fuente, Oscar & Sánchez Loppacher, Juan. *Evaluación y Diagnóstico de la Gestión Municipal*. Final Report. May 2001.

Oficina de Planeamiento y Presupuesto. *Evaluación del Componente de Fortalecimiento Institucional del Programa de Desarrollo Municipal III*. December 2002.

Prud'homme, Rémy and Huntzinger, Hervé. *Descentralización y Relaciones Intergubernamentales en el Uruguay*. October 2001.

Tiribocchi Barrelli, Alexandra. *Evaluación Ambiental del PDM III y PDGM IV*. 2002.

Execution:

Operating Regulations of the Program. Version agreed on during the negotiations.

ABBREVIATIONS

APO	Annual plan of operations
CESP	Centro de Evaluación y Supervisión de Proyectos [Project Evaluation and Supervision Center]
CNR	Central Nacional de Registro [National Registration Center]
DG	Departmental government
DINAMA	Dirección Nacional de Medio Ambiente [National Environment Office]
DNC	Dirección General de Catastro Nacional [National Real Estate Registry Office]
ECH	Continuous household survey
EIA	Environmental impact assessment
EIRR	Economic internal rate of return
EMP	Environmental management plan
ESMP	Environment and social management plan
FDI	Fondo para el Desarrollo del Interior [Interior Development Fund]
FIRR	Financial internal rate of return
GDP	Gross domestic product
IDRC	Canada's International Development Research Centre
IMF	International Monetary Fund
MTOP	Ministry of Transportation and Works
OC	Ordinary Capital
OPP	Oficina de Planeamiento y Presupuesto de la Presidencia de la República [Executive Branch Planning and Budget Office]
OR	Operating Regulations
OSE	Obras Sanitarias del Estado [State Sanitation Company]
PAII	Institutional action and investment plan
PAR	Project analysis report
PDGM	Municipal development management program
PDM	Programa de Desarrollo Municipal [municipal development program]
PEA	Preliminary environmental authorization
POM	Municipal works program
PTI	Poverty-targeted investment
RUC	Taxpayer master file
SIAF	Combined financial management system
UBN	Unmet basic needs
UDM	Unidad de Desarrollo Municipal [municipal development unit]
UNDP	United Nations Development Programme



Inter-American Development Bank
Regional Operations Support Office
Operational Information Unit

Uruguay

Tentative Lending Program

2003

Project Number	Project Name	IDB US\$ Millions	Status
UR0131	Municipal Development and Management	60.0	
UR0150	Banking System Strengthening Sector Loan	200.0	
Total - A : 2 Projects		260.0	
*UR0152	ABN Amro Uruguay TFF	12.5	
Total - B : 1 Projects		12.5	
TOTAL 2003 : 3 Projects		272.5	

2004

Project Number	Project Name	IDB US\$ Millions	Status
UR0141	Cattle Development Program	25.0	
Total - A : 1 Projects		25.0	
UR1001	Highway Infrastructure Program	70.0	
UR1002	Program to Support Employment Generation	N/A	
Total - B : 2 Projects		70.0	
TOTAL - 2004 : 3 Projects		95.0	
Total Private Sector 2003 - 2004		12.5	
Total Regular Program 2003 - 2004		355.0	

* Private Sector Project



URUGUAY

IDB LOANS

APPROVED AS OF AUGUST 31, 2003

	US\$Thousand	Percent
TOTAL APPROVED	3,339,701	
DISBURSED	2,928,770	87.69 %
UNDISBURSED BALANCE	410,931	12.30 %
CANCELATIONS	316,023	9.46 %
PRINCIPAL COLLECTED	779,527	23.34 %
APPROVED BY FUND		
ORDINARY CAPITAL	3,193,786	95.63 %
FUND FOR SPECIAL OPERATIONS	104,079	3.11 %
OTHER FUNDS	41,836	1.25 %
OUTSTANDING DEBT BALANCE	2,149,244	
ORDINARY CAPITAL	2,120,580	98.66 %
FUND FOR SPECIAL OPERATIONS	28,663	1.33 %
OTHER FUNDS	0	0.00 %
APPROVED BY SECTOR		
AGRICULTURE AND FISHERY	265,652	7.95 %
INDUSTRY, TOURISM, SCIENCE AND TECHNOLOGY	425,245	12.73 %
ENERGY	116,984	3.50 %
TRANSPORTATION AND COMMUNICATIONS	343,084	10.27 %
EDUCATION	147,131	4.40 %
HEALTH AND SANITATION	403,694	12.08 %
ENVIRONMENT	0	0.00 %
URBAN DEVELOPMENT	235,676	7.05 %
SOCIAL INVESTMENT AND MICROENTERPRISE	624,578	18.70 %
REFORM AND PUBLIC SECTOR MODERNIZATION	658,496	19.71 %
EXPORT FINANCING	8,940	0.26 %
PREINVESTMENT AND OTHER	110,221	3.30 %

* Net of cancellations with monetary adjustments and export financing loan collections.



URUGUAY

STATUS OF LOANS IN EXECUTION AS OF AUGUST 31, 2003

(Amount in US\$ thousands)

APPROVAL PERIOD	NUMBER OF PROYECTS	AMOUNT APPROVED*	AMOUNT DISBURSED	% DISBURSED
<u>REGULAR PROGRAM</u>				
Before 1997	2	207,300	160,108	77.23 %
1997 - 1998	7	410,355	378,190	92.16 %
1999 - 2000	4	90,825	17,718	19.51 %
2001 - 2002	7	526,600	274,225	52.07 %
<u>PRIVATE SECTOR</u>				
2001 - 2002	1	10,500	6,000	57.14 %
TOTAL	21	\$1,245,580	\$836,241	67.14 %

* Net of cancellations. Excludes export financing loans.

MUNICIPAL DEVELOPMENT AND MANAGEMENT PROGRAM

(UR-0131)

EXECUTIVE SUMMARY

Borrower:	Eastern Republic of Uruguay	
Executing agency:	Oficina de Planeamiento y Presupuesto de la Presidencia de la República [Executive Branch Planning and Budget Office] (OPP)	
Amount and source:	IDB: (OC)	US\$60 million (80%)
	Local:	<u>US\$15 million (20%)</u>
	Total:	US\$75 million (100%)
Financial terms and conditions:	Amortization period:	25 years
	Grace period:	5 years
	Disbursement period:	5 years
	Term for physical initiation of works:	51 months
	Interest rate:	variable
	Inspection and supervision:	1%
	Credit fee:	0.75%
	Currency:	Single Currency Facility in U.S. dollar
Objectives:	<p>The program's objective is to improve the fiscal situation of the departmental governments (DGs) outside of the metropolitan Montevideo area, upgrade the quality of municipal services and make their delivery more efficient. The program's specific objectives are to: (i) develop instruments to formulate and implement decentralization policies; (ii) put into place an incentives system and support measures to improve the fiscal performance and management efficiency of the DGs; and (iii) service the interior departments' urban, social and economic development investment needs in an efficient and targeted manner.</p>	
Description:	<p>To accomplish these objectives, the program will finance three components: (i) sector development; (ii) departmental performance enhancement; and (iii) departmental and regional investments.</p>	

1. Sector development (US\$470,000)

The goal of this component is to devise the tools with which to make and implement decentralization policies. To accomplish these objectives, the component will have the following subcomponents: (i) sectoral framework, involving the funding of studies and workshops to examine the country's decentralization process and to help craft proposals for moving the process forward; (ii) strengthening of the Unidad de Desarrollo Municipal [municipal development unit] (UDM), involving funding for consulting services to train UDM technicians in techniques of project evaluation, to modernize the UDM's internal procedures, and to design and implement a financial and departmental performance data system; and (iii) strengthening of the *Congreso de Intendentes* [Association of Mayors], involving funding of technical assistance to institutionalize the *Congreso's* functions.

2. Departmental performance enhancement (US\$6.5 million)

The purpose of this component is to develop instruments that will make the DGs more efficient through projects that will build up their technical capacity and their operating systems.

a) Municipal management (US\$4.2 million)

This subcomponent will fund the design and implementation of procedures and systems that improve municipal management in the following areas: tax and financial management; procurement and asset management; personnel; land management, municipal digests; citizen services and social participation.

b) Cadastre and taxpayer master file (US\$1.9 million)

The goal of this subcomponent is to provide municipal governments with a current record of taxpayers, as a means to assist in their efforts to collect taxes and recover taxes owed by tax evaders or delinquent taxpayers.

c) Training (US\$360 thousand)

Under this subcomponent approximately 40 civil servants per municipal government will be instructed in the principal areas of municipal management (finance, taxation, procurement, human resources, and so on) and in investment-project management (including project formulation and analysis, and supervision and maintenance of works).

3. Departmental and regional investments (US\$58 million)

The purpose of this component is to address the investments needed for urban, social and economic development in the interior departments in an efficient and targeted manner. The component will finance projects that match the departments' socioeconomic development priorities, as set forth in their institutional action and investment plans (PAII). The eligible sectors are: preinvestment, neighborhood improvement and consolidation, urban streets and roads, environmental recovery and sanitation, micro- and macro-drainage lines, urban utilities and local economic development.

The Bank's country and sector strategy:

The Bank's strategy in Uruguay for the 2000-2004 period is to achieve sustained growth with stability, which in turn will improve social equity. The Bank's strategy focuses on supporting: (i) competitiveness and regional integration; (ii) modernization of the State and good governance; and (iii) social welfare and equity.

The Bank's subnational development strategy, approved by the Board of Executive Directors in May 2001, states that the Bank will help the countries implement the reforms and institution- strengthening activities required to turn subnational governments into efficient and democratic institutions capable of performing the functions of: (i) promoting economic development within their jurisdictions; (ii) providing the services needed to ensure good living conditions for the population and to enhance the degree of social and territorial equity in the distribution of the benefits of development; and (iii) providing infrastructures that are essential to the well-being of the population and for the growth of economic activities.

The proposed program fits into both strategies and directly impacts the second strategic area. The departmental governments will need institutional, financial and management-related support and assistance to enable them to contribute to the decentralization process prescribed by law. Consideration must be given to regional differences and to the problems that the various areas of the country have, and to enlisting the private sector into the transformation process.

Coordination with other development agencies:

Through its Environmental Services Systems in Vulnerable Communities program, since 1996 the Environmental Management Secretariat of Canada's International Development Research Centre (IDRC) has been directly assisting municipalities in Uruguay with research to solve the cities' specific environmental services problems. The World Bank has made a loan of US\$27 million to Obras Sanitarias del Estado [State Sanitation Company] (OSE) for the purpose of developing the water and sanitation sector and its policies on a national scale. Both programs dovetail with the activities the

present program will fund at the local level (paragraphs 1.40 and 1.41).

Environmental and social review:

The positive environmental and social impacts that the investments made under the program will have will differ by sector and will include the following: (i) improved living conditions and health indicators, associated with the projects in sanitation, storm sewers, and comprehensive solid waste management; and (ii) an improved environment in the departments, achieved by restoring degraded areas and controlling erosion and sedimentation, removing environmental liabilities, creating parks and green areas, and strengthening the DGs' environmental management. Having internalized lessons learned from previous programs, this program features environmental protection measures that improve: (i) the environment-related eligibility criteria, and (ii) the project cycle, from conception, design, evaluation, inspection and environmental monitoring (see Section A of Chapter IV).

Benefits:

The main benefits of the Municipal Development Management Program IV (PDGM IV) will accrue from the improvement in the departmental governments' fiscal and tax management, brought on by the program's financial incentives and technical support. With this program, a change is being introduced in the formula used to distribute program funds and funds from the Fondo de Desarrollo Interior [Interior Development Fund] (FDI). The new formula adds two more variables related to the inverse relationship between per capita gross domestic product (GDP) and unmet basic needs (UBN). The change is intended to achieve greater horizontal equity among the municipalities in the interior. Direct benefits are also expected to accrue from the physical investments, which represent more than 80% of the program's expenditures. Based on the sample prepared for this program, the latter is expected to benefit a total of 95,000 households directly and indirectly. Of these, 48,000 will be households with UBN. Ex post evaluations done of past projects found that a significant portion of the benefits that families realize from the construction works is in the form of higher urban property values.

Risks:

Uruguay's economic problems were exacerbated by Argentina's economic and financial problems. The Uruguayan government responded by implementing fiscal adjustments under agreements with the International Monetary Fund (IMF). The risk that this poses for the program is that of a reduced budgetary appropriation, which could affect the pace of program execution. However, the fiscal limitations forecast in the projections prepared pursuant to the IMF agreement were taken into account when determining the size the program, and the disbursements planned for 2004 and 2005 were scaled back accordingly. With the revenue-sharing commitment between the

central government and the DGs, more financing is likely to be freed up for transfer payments and for phase four of the municipal development and management program.

While any change in the country's administration in 2005 could shift the priority assigned to programs already in progress, this would not appear to pose a threat to the PDGM IV as the latter is part of a political commitment between the central government and the departments on the subject of revenue sharing. That commitment is also guaranteed under the Five-Year Budget Act, which will still be in effect in the new administration's first year in office.

Another potential risk is that some departmental governments will fall short of the fiscal and budgetary goals that the program proposes. To minimize this possibility, the program's design has built in financial incentives and the tools needed to attain the goals, such as instruments for financial control, tax collection and others intended to improve the municipalities' capacity to save and invest.

With the natural turnover of intendentes that will occur while the program is underway, the incoming municipal governments may have other priorities, which could compromise the commitment undertaken to balance municipal accounts. The consensus—built during the workshop attended by those involved and at various meetings with the intendentes and their Congreso—and the PAIIs, which provide for a closer relationship and continuous monitoring, reduce the risk that the agreements signed will be changed.

**Special
contractual
clauses:**

As conditions precedent to the first disbursement: (i) the model participation agreement between the DGs and the Oficina de Planeamiento y Presupuesto [Planning and Budget Office] (OPP) establishing the latter's obligations under the program on the terms agreed with the Bank, must have been submitted to the Bank; (ii) the Operating Regulations must have been implemented on the terms agreed with the Bank; (iii) the OPP must have designated the UDM as the program coordinating unit, appointed the general coordinator and the sub-coordinators for the investment and institutional strengthening components and must have engaged an environmental specialist and a project economist for the UDM through a competitive process; and (iv) a contract has been signed between the UNDP and OPP establishing their obligations under the program, and such contract is in effect (see paragraphs 3.5 and 3.11).

As conditions precedent to participation by the GDs in the program: (i) a participation agreement must be signed with the OPP, on the terms agreed with the Bank, with a commitment to be bound by the terms of the loan contract and Operating Regulations; and (ii) a PAII must have been approved by the UDM (see paragraph 3.9).

As special implementing conditions, (i) the UDM staff must be hired through a competitive process; (ii) the eligibility criteria for access to the investment component and the land cadastre and registration subcomponent; (iii) the sanitation works must have been fulfilled; (iv) the contribution of municipal resources; (v) the program baseline, the findings of the hedonic study, and the midterm evaluation (paragraphs 3.7, 3.10, 3.17, 3.28, 3.32, 3.33, 3.45; 3.46; and 3.47).

In addition, it was agreed that an ex post financial evaluation funded by the OPP would be conducted (paragraph 3.49).

Poverty-targeting and social sector classification:

This operation qualifies as a social equity-enhancing project as described in the indicative targets mandated for Bank activity in the report on the Eighth Replenishment (document AB-1704). It also qualifies as a poverty-targeted investment (PTI). The borrower will not use the additional 10% financing (see paragraphs 4.13 and 4.14).

Exceptions to Bank policy:

None.

Procurement:

Program-related contracting and procurement will be done according to standard Bank procedure. International competitive bidding will be required for works contracts valued at US\$2 million or more, for procurements of goods valued at US\$350,000 or more and consulting contracts of US\$200,000 or more.

Price can be used as a criterion for selecting consulting services, as stipulated in document GN-1679-3. When a combination of price and the quality of the technical proposal are used for the evaluation done to select consulting firms, price will never be assigned more than a 20% weighting, and the quality of the technical proposal no less than 80%.

The threshold for autonomous project approval by the UDM will be US\$80,000 for procurements of goods and contracting of related services, including consulting services, and US\$500,000 for works. The Bank may conduct ex post reviews of a sampling of the bidding documents and procedures used in these cases (see paragraphs 3.34 to 3.36).

Recognition of expenditures:

An amount of up to US\$200,000 may be charged to the Bank loan for expenses incurred in the 18 months previous to the loan-approval date for activities to strengthen the UDM, to conduct studies for the economic analysis and to prepare the baseline for the program, provided the contracting and procurement procedures used were substantially similar to those used by the Bank (see paragraph 3.38).

I. FRAME OF REFERENCE

- 1.1 Uruguay has two main levels of government: the central government and the 19 departmental governments (DGs), also called municipal governments. The DGs, in turn, are that of capital city Montevideo and the 18 departments in the country's interior.¹
- 1.2 The dichotomy between Montevideo and the interior departments is striking. Montevideo accounts for 42% of the country's 3.2 million people and some 60% of its gross domestic product (GDP). Given the enormous disparity between the capital and the interior departments, unparalleled anywhere in the world except for city-states like Singapore and Hong Kong, the country has had to devise instruments to promote development in the interior departments.
- 1.3 Population density in the interior departments is sparse (9.3 persons per km²) and departmental populations average around 100,000. While every department has more than one urban center, the 18 departmental capitals account for the bulk of the departments' population. Table I-1 reveals the differences among the interior departments on certain key indicators:

Table I-1
Interior Departments: Diverse Indices

Department	Population	Per capita GDP (1999) (US\$)	Households with UBN (%)	Per capita income / dept. (US\$)	Per capita rev. sharing (US\$)	Dept. Income/GDP (%)
Artigas	75,059	3,809	24.1	141	46	3.7
Canelones	443,054	3,191	17.9	104	22	3.3
Cerro Largo	82,510	4,194	28.7	139	51	3.3
Colonia	120,241	5,834	13.3	172	34	2.9
Durazno	55,716	4,703	25.1	172	59	3.9
Flores	25,030	5,054	18.3	246	82	4.9
Florida	66,503	5,424	21.1	167	58	3.1
Lavalleja	61,085	4,285	22.8	172	47	4.0
Maldonado	127,502	6,870	15.7	681	85	9.9
Paysandú	111,509	5,256	20.5	180	41	3.4
Río Negro	51,713	5,046	18.9	208	73	4.1
Rivera	98,472	2,950	27.9	103	45	3.5

¹ The DGs are headed by a municipal *intendente* and a departmental board elected by popular vote every five years. The office of the municipal *intendente* has executive functions, while the departmental board's functions are legislative and supervisory. Departments can opt to have local authorities in communities of over 10,000 and in the departmental capitals. However, the function of local government is performed by the DGs, a government unit that can best be likened to municipal governments in other countries of the region.

Department	Population	Per capita GDP (1999) (US\$)	Households with UBN (%)	Per capita income / dept. (US\$)	Per capita rev. sharing (US\$)	Dept. Income/GDP (%)
Rocha	70,292	5,059	22.1	249	50	4.9
Salto	117,597	4,234	23.9	191	56	4.5
San José	96,664	4,038	20.1	120	35	3.0
Soriano	81,557	5,034	16.8	196	54	3.9
Tacuarembó	84,919	4,723	28.1	199	55	4.2
Treinta y Tres	49,502	5,069	25.3	157	62	3.1
Total/Average	1,818,925	4,441	20.6	191	45	4.3

- 1.4 The population of the largest department, Canelones, which includes parts of the outskirts of metropolitan Montevideo, is nearly three times that of the next largest department, Maldonado. Social conditions, measured by the percentage of households with UBN, vary from 13.3% in Colonia to 28.7% in Cerro Largo, revealing an inverse relationship between the population with UBN and per capita GDP.
- 1.5 One of the greatest differences among the departments is in per capita GDP, which is higher in the southern region, which includes Maldonado, Colonia, Rocha and Canelones, and lower in the central and northern reaches of the country. The department of Rivera has the lowest per capita GDP (US\$2,950). The fiscal effort, measured by the ratio of departmental revenues to GDP, varies markedly, from a low of 2.9% in Colonia to as high as 9.9% in Maldonado. Per capita income in Maldonado is 2.5 times what it is in the next interior department in order of per capita income, and comes mainly from the Punta del Este beach resort.

A. Decentralization

- 1.6 The 1996 constitutional amendment launched a decentralization process that for the first time created an institutional framework for formulating and carrying out decentralization policies. This process took another major step forward on the financial front with passage of the National Budget Act for 2000-2004, which reformed the revenue-sharing system. With this reform, the country made a commitment to annual, graduated transfers of funds to the departments, which substantially increase local resources. It also created a new instrument for revenue sharing with the DGs: the Fondo para el Desarrollo del Interior [Interior Development Fund] (FDI).
- 1.7 The following is a more detailed description of the municipal sector's institutional framework, departmental responsibilities, local finances and the revenue-sharing system. This is followed by an account of the lessons learned from previous Bank programs in the sector and the strategy that this program will use to propel the decentralization process forward.

1. The municipal sector's institutional framework

- 1.8 The 1996 constitutional reform defined the institutional framework for implementation of the decentralization. First, it assigned the functions of planning and implementing the State's decentralization policies to the OPP. Second, it created a Sectoral Commission on Decentralization and Development, composed of the *Congreso de Intendentes* (Association of Mayors) and the Central Government, and charged with assisting the OPP in making decentralization policy. Finally, it institutionalized the *Congreso de Intendentes* as a body representing the DGs.
- 1.9 Although defining the institutional framework was an important step in the decentralization process, the institutions involved do not yet have the key elements needed to perform their new functions effectively: (i) although the OPP has a municipal development unit (UDM), it is not fully staffed; (ii) the Sectoral Commission does not yet have all of the instruments that are needed to become fully functional; and (iii) the *Congreso de Intendentes* has institutional weaknesses, as it has no management and technical staff exclusively for the Congress' administration, no sustainable financing base and no technical capacity to provide services to the departments.

2. The departmental responsibilities

- 1.10 The DGs are responsible for urban maintenance services, the infrastructure of urban and secondary roads, collection and final disposal of waste, markets, cemeteries, slaughterhouses, as well as regulatory functions in public health and hygiene. While their functions do not include sanitation (water and sewer), education and health, in recent years the DGs have been taking on a greater role in the social sector, specifically in the following areas: (i) primary health care, by building and operating departmental polyclinics and supporting national polyclinics; (ii) maintenance of school buildings, high schools and public libraries; (iii) construction and operation of municipal soup kitchens and snack bars; (iv) support to electrification plans, and (v) implementation of water and sanitation systems in rural areas. Under pressure from their constituents, the DGs have now ventured into new territory: local economic development.²

3. Municipal finances

- 1.11 The following table illustrates some DG fiscal indicators for the period between 1994 and 2001:

² The *intendentes* made this sector a priority at the stakeholders' workshop held in November 2001. In the interviews conducted during program preparation, they expressed an interest in promoting job creation and business ventures within their departments.

Table I-2 Budget Execution (1999 US\$ millions) and Selected Fiscal Indicators								
CATEGORY	1994	1995	1996	1997	1998	1999	2000	2001
INCOME	361.9	525.8	660.8	711.8	660.0	467.2	431.5	419.4
Departmental	298.2	435.1	533.7	583.0	526.7	367.9	288.6	260.5
Central government	63.7	90.7	127.1	128.8	133.3	99.3	142.9	158.9
EXPENDITURES	405.6	535.6	665.6	719.8	668.9	542.8	479.2	459.8
Personnel	200.0	277.3	337.4	354.5	317.6	251.5	246.9	260.2
Investments	112.7	138.0	149.9	187.9	173.8	149.5	93.9	90.7
Other	92.9	120.3	178.3	177.4	177.5	141.8	138.4	108.9
PERFORMANCE	-43.7	-9.8	-4.8	-8.0	-8.9	-75.6	-47.7	-40.4
INDICATORS								
Fiscal year's earnings over expenditures	-11.0%	-1.8%	-0.7%	-1.1%	-1.3%	-13.9%	-10.0%	-8.8%
Borrowing	24.3%	23.5%	25.5%	22.7%	25.1%	35.8%	46.9%	56.9%
No. employees per 1,000 inhabitants	15.9	14.9	14.7	14.5	14.8	14.7	14.8	14.5
% Personnel costs/total Expenditure	49.3	51.8	50.7	49.5	47.5	46.3	51.5	56.6

a. Department-generated revenues

- 1.12 The department-generated revenues include real estate and vehicle taxes, rates charged for services provided and other smaller revenue streams like fines. The combined department-generated revenues for the 18 DGs was 62% of total revenues in 2001, but that figure varies according to the size of the municipality: in municipalities of more than 100,000 inhabitants, department-generated revenue is 68% of total revenue, a figure that drops to 52% in municipalities of fewer than 100,000. The above table shows that municipal financial dependence increased in the 1994-2001 period, as the central government's revenue sharing increased. This will be examined later.

b. Spending

- 1.13 Public spending is not very decentralized in Uruguay. The government expenditures of the 18 interior departments, which totaled US\$460 million in 2001, represent 13% of total public spending in Uruguay, indicating that there is room for greater fiscal decentralization. In countries like Bolivia, which has a unitary system and is in the midst of a far-reaching decentralization process, or Venezuela, which has a very centralized federal system, those percentages are much higher (26.7% and 19.6%, respectively).
- 1.14 The DGs have very high personnel costs and very low investment expenditures. Personnel costs averaged 49% of total expenditures between 1994 and 1999 and

rose to 56% in 2001; investment expenditures, on the other hand, averaged 26% of total spending between 1994 and 1999, and then dropped to 20% in 2000 and 2001. Having said this, the incentives provided under the Municipal Development Program (PDM) III to induce departments to improve their management performance did succeed in lowering the departments' personnel costs and increasing their investment spending in 1998 and 1999.

- 1.15 Central government authorities are disturbed by the departments' fiscal deficit and borrowings,³ which have been on the rise. This was especially true between 1999 and 2001, when the deficit reached 13% and borrowing 57%. An analysis of the debt profile in a sampling of departments reveals that the bulk of the debt stock is made up of non-negotiated debts with autonomous central government entities like the electric power and sanitation companies or the social security system. In this sample of departments, non-negotiated debt represents 60 to 85% of the debt stock. One of the central government's purposes in this program is to change this profile by instilling practices and creating incentives for sound fiscal management.
- 1.16 The lack of tax- and financial-management tools and high personnel costs are among the principal reasons why the departments' borrowing levels have been on the rise. In the taxation area, with no taxpayer master file, no pre-billing of property taxes, and no collection and auditing procedures, delinquency has risen dramatically (for example, delinquency on urban property taxes rose from 45% in 1997 to 77% in 2001).

4. The revenue-sharing system

- 1.17 The country's revenue-sharing system has grown substantially in recent years and looks to grow even more in the future. Whereas in 1990 the central government's transfers to departmental governments represented 15% of the departments' resources, that figure had increased to 30% by 2001. The increased revenue sharing came about largely as a result of the reforms that the 2001-2004 Budget Act introduced, which included: (i) gradually increasing, annual percentages of the central government's revenues earmarked for revenue sharing; (ii) a new global distribution; and (iii) creation of an investment fund for the interior departments, with a new formula for allocating funds.
- 1.18 The Budget Act determined what percentage of the central government's revenues was to be transferred to the DGs each year. It also added another item to the existing revenue-sharing system, which is a sum of money that departments are free to use as they choose as it is not earmarked for any specific category of spending. Lastly, the reform created the FDI, made up of a percentage of the tax revenues generated in the interior departments and transferred back to them. These funds are

³ Borrowing is debt stock over income. The debt stock includes negotiated and non-negotiated debt.

divided among the departments according to a formula that factors in population, territory, number of households with UBN and its inverse relationship to GDP. The resources from the FDI go toward urban and economic investment projects pre-qualified by the Sectoral Decentralization and Development Commission and the OPP. Table I-3 summarizes the structure of this new revenue-sharing system:

Table I-3 Evolution of the new revenue-sharing system (in millions US\$)				
Components of the new system	2001	2002	2003	2004
Previous system (a) <i>The bulk going to 18 interior departments</i>	120.0	120.0	120.0	120.0
Global distribution (b) <i>For the 18 interior departments</i>	20.0	30.0	30.0	40.0
Remainder to complete annual % share (c) <i>For all 19 departments</i>	8.7	7.5	7.5	5.3
FDI <i>For the 18 interior departments</i>	10.0	15.0	20.0	25.0
TOTAL	158.7	172.5	177.5	190.3

Source: Prud'homme and Huntzinger, 2001, and survey done with the OPP.

- 1.19 These reforms will increase transfers to the departments by some 58%, from US\$120 million annually to an annual US\$190 million by 2004. In general, the reforms have made the country's revenue-sharing system more efficient. The new system appreciably increases the DGs' resources. The introduction of a global distribution that the DGs can use at their discretion gives them more autonomy in the use of these funds, while the introduction of the new revenue-sharing formula ensures that the transfers match the departments' needs.

B. The Bank's role in Uruguay's decentralization process

1. The Municipal Works Programs I and II and the Municipal Development Program III

- 1.20 The Bank has financed three municipal development programs to assist the country's interior departments. The total cost of the Municipal Works Program (POM) I approved in 1984 was US\$50 million; POM II, approved in 1990, cost a total of US\$35 million; approved in 1997, the Municipal Development Program (PDM) III cost a total of US\$78 million, and is still underway, with over 98.5% of the funds disbursed. The MTOP and the DGs partnered to carry out POM I and II, whereas the PDM III was carried out by the OPP and the DGs.
- 1.21 The objective of POM I was to make delivery of municipal services more efficient and to create cost-recovery mechanisms. POM II emphasized improved living

conditions, as well as improved management of property records. The focus of PDM III was on strengthening the DGs as promoters of local development, to strengthen their capacity to plan and promote development, and to rationalize spending and increase the departments' financial resources.

- 1.22 The following is a summary of the chief results of PDM III, the lessons learned, challenges in the sector and the strategies that the new program adopts to take on those challenges.⁴

2. Results of PDM III, lessons learned and the new program's strategies

a. Effects on the institutional framework

- 1.23 From the institutional standpoint, PDM III has had good results. Under the program, the Unidad de Desarrollo Municipal [municipal development unit] (UDM) was set up in the OPP, consisting of three sections: an office of the coordinator of institutional strengthening, an office of the coordinator of investments, and a support services section. Under PDM III, a database on the municipal sector was developed, as were manuals and other tools to help departments formulate projects in institution building and investments. The institutional structure that the program created put the OPP at the forefront of the decentralization process.
- 1.24 Despite the progress made, the institutional framework still has critical flaws: (i) the OPP has not incorporated the UDM into its organization chart, finance its costs and make its staff permanent; and (ii) there are areas in which the data system on the municipal finances needs improvement: the integration of information on the *Intendencias* and the *Congreso*, the tools needed to analyze the data, and its dissemination. The Municipal development management program (PDGM) IV will enable the UDM to become a permanent part of the OPP's organizational structure and budget, and to design a complete data system on departmental finances and management. This will improve monitoring, make municipal management and finances more transparent, and give the OPP the staff it will need to carry on these functions once the present program is completed.

b. Intergovernmental relations

- 1.25 In the area of intergovernmental relations, the PDM III introduced a component into the country's revenue-sharing system to serve as an incentive to better departmental management. It reserved 30% of the investment funds for municipalities that attained their performance targets. In 1998, of the 18 departments that participated in the program, 11 had attained the targets and availed themselves of the funds that

⁴ Evaluations of PDM III appear in the following studies: Prud'homme and Huntzinger (2001), Cracel (2002), Lebedinsky (2002) and GPI consultants (2002).

rewarded reduced personnel costs and increased investment. This incentives system was quite effective, with the result that indicators for 1998 and 1999 improved, as noted previously. However, the incentives were not sustained and the targets did not take aim at the most critical aspects of municipal management. Furthermore, the revenue-sharing formula used under the previous program did not take equity considerations into account.

- 1.26 The new program retains the incentives system started under the earlier program, but adds the following improvements: (i) more funds will be reserved to reward good management practices; (ii) the revenue-sharing formula being introduced considers variables like population, territory, and an inverse relationship between the number of households with UBN and GDP; (iii) performance incentives are included that become annual as of the program's third year, in order to ensure that the enhancement efforts continue; and (iv) the indicators are improved by linking the indicators of increased income and reduced personnel costs with the indicators of financial performance (deficit or surplus) and borrowing; the personnel indicator is strengthened by capping personnel costs as a percentage of total expenditures

c. Efficiency and targeting of investments

- 1.27 PDM III financed 66 investment projects, 46 of which have already been completed. The projects cost around US\$1 million each and on average were executed within the space of one year. The investment sectors in greatest demand were neighborhood improvement and drainage, which respectively accounted for 53% and 35% of the investments. The ex post evaluation of a sampling of investment projects found two major problems with the investments component.
- 1.28 It was found by applying a rigorous methodology to a sample of eight projects and taking the actual deadlines into account, that just three of the projects posted a return above the level established for the program. The reasons for this are attributable to two factors depending on the case: (i) the economic analysis used in the methodology was inadequate; and (ii) the periods for construction contracts were extended and their amounts increased. A second shortcoming having to do with the way in which investment resources are allocated concerns the lack of any formal mechanism for programming and coordinating investment funded from other sources such as FDI.
- 1.29 The PDGM IV will introduce the following measures to make the investments more efficient and better targeted: (i) the project-preparation guidance that the UDM provides to the DGs will be enhanced by formally instituting prior consultations and by expanding and rewriting the project formulation handbook; (ii) project analysis will be improved by revising the procedure used to analyze investments and the criteria used to target them, by developing tools that can be used in the analysis, and by introducing formal project-analysis procedures into the project cycle; (iii) rules will be introduced for authorizing cost overruns and

deadline extensions; and (iv) an instrument will be introduced for programming and coordinating central-government-funded investments in the departments. Chapter II describes the Institutional Action and Investment Plans that will be used to program and coordinate investments in the departments. Chapter III describes the new project cycle, and Chapter IV expands the analysis on the ex ante and ex post evaluation of program-funded investment projects.

d. Institutional strengthening of the departments

- 1.30 The institutional strengthening component under the previous phase financed the introduction of four administrative systems modules, technical assistance in three areas of municipal management and training of 2,000 civil servants. Every municipality received the same sum and was to identify and select the strengthening activities for its department. This component produced very uneven results: some departments invested their funds in strategic ways and thus appreciably improved their internal management systems. Flores is one example, having invested in a combination tax-management, budget-management and personnel-management package. The results in other municipalities, however, were not as good.
- 1.31 A number of changes have been introduced with the present program to ensure that investments will have a greater impact on departmental performance. First, the performance incentives system for the *intendencias* has been changed, as mentioned earlier. Second, the program's strengthening activities have been set up so that every department receives a basic package of systems and procedures—for managing finances, taxes, procurements and assets, and human resources—so that all departments are guaranteed a minimum standard of management quality. In the tax-management area, the program will introduce the taxpayer master file, which will enable DGs to pre-bill for property taxes. The financial-management priority is to introduce procedures to control cash flow, and financial planning procedures that will, among other things, make it easier to plan commitments based on the funds actually available. As for procurements and assets, inventory control systems will be introduced and procurement procedures will be streamlined. The program will also help put into place a personnel management system that will, *inter alia*, rationalize municipal personnel.
- 1.32 Finally, the present program features one very fundamental difference: the incentives associated with the process of monitoring the performance indicators. At the start of the operation, each department will prepare an institutional and financial study (see paragraph 2.10) which will establish the baseline for the performance indicators and the latter's annual targets (fiscal year performance, borrowing, personnel, delinquency, investment level, degree of municipal autonomy, costs of the principal municipal services, and so on). The UDM will monitor these indicators each year and make them available to the public on a municipal data system, thereby making it possible to compare the departments' efficiency and serving as an incentive to good management practices. The institutional action and

investment plan (PAII) will thus become an established tool for reviewing departmental performance goals.

C. The challenges of decentralization and the support that the proposed program provides

- 1.33 The decentralization process in Uruguay, which was deepened with the 1996 constitutional reform and put into effect with the enactment of the 2000-2004 Budget Act, has been making headway in recent years, with the support of the Bank's program. An institutional framework was created for promoting decentralization; reforms to the revenue-sharing system made it more transparent; the amount of revenue shared with the departments increased, and the DGs were allowed more discretion in the use of these funds. The system was made more efficient when variable indicators were added to the distribution formula to take the departments' needs into account.
- 1.34 As discussed at the start of this chapter, the process still has problems in some areas: (i) the institutions in charge of the decentralization (OPP, Comisión Sectorial para la Descentralización [Sectoral Decentralization Commission] and the *Congreso de Intendentes*) need to be strengthened and the tools required to perform their new functions; (ii) financial management of a number of departments has been alarmingly poor; and (iii) although the revenue sources available to the departments have increased, not enough mechanisms have been devised to orchestrate them.
- 1.35 To meet these challenges, the program plans measures to strengthen the institutions in the sector. Under the program, Uruguay's departments will be equipped with the management tools needed to increase their tax revenues, plan their expenditures and trim personnel costs. A financial incentives system will reward departments that attain the departmental performance indicators. The UDM will have an instrument with which to program investments department-by-department and a municipal financial data system. The latter will be made available to the public to ensure greater transparency and to enable performance comparisons, and thus serve as an added incentive to improve performance.

D. The Bank's country and sector strategy

- 1.36 The Bank's strategy in Uruguay for the five-year period 2000-2004 is to achieve sustained growth with the kind of stability that will improve social equity. The focus of the strategy is on supporting: (i) competitiveness and regional integration; (ii) modernization of the State and good governance to reduce the State's weight in the economy, improve its efficacy and efficiency, rationalize and target its intervention and decrease its impact on the national production of goods and services, and (iii) efforts aimed at improving social well-being and increasing social equity, while mainstreaming the most vulnerable groups into the development process and offering them a better quality of life.

- 1.37 The Bank's subnational development strategy, approved by the Board of Executive Directors in May 2001, provides that the Bank will assist countries with implementing the reforms and institution-strengthening activities required to build efficient and democratic subnational governments capable of performing the following functions: (i) promoting economic development in their jurisdictions; (ii) providing services to ensure good living conditions for the population and to enhance the degree of social and territorial equity in the distribution of the benefits of development; and (iii) providing infrastructures that are essential for the well-being of the population and for the growth of economic activity.
- 1.38 The proposed program fits into both strategies and directly impacts the Bank's second strategic area with Uruguay. Departmental governments need to be assisted and strengthened on the institutional, financial and management fronts so that they are able to contribute to the decentralization process that the law prescribes. At the same time, however, regional differences have to be taken into account, as must the problems that the various areas of the country have. The private sector, too, must be enlisted into the transformation process.
- 1.39 The Bank currently has three programs that dovetail with the activities planned under PDGM IV. The sanitation program (UR-0089) and institutional modernization program (UR-0139), both for Montevideo, improve the coverage and quality of the sanitation system in the metropolitan area and modernize the municipal government so that it is better able to provide municipal services and more adept at fiscal management. The Program for the Integration of Irregular Settlements (UR-0123) offers comprehensive funding to vulnerable neighborhoods, especially in metropolitan Montevideo where the majority of these irregular settlements are located. The present program will carry these measures into the interior departments.

E. Coordination with other multilateral development institutions

- 1.40 Two major programs in Uruguay's municipal sector complement the measures planned under this program. The first is one by the Environmental Management Secretariat for Latin America and the Caribbean, administered by the International Development Research Centre (IDRC) with support from Canada and the Bank. Through the Environmental Services Systems in Vulnerable Communities program, it has helped cities conduct research to solve their specific environmental services problems.
- 1.41 The World Bank has a loan of US\$27 million currently in progress with Obras Sanitarias del Estado [State Sanitation Company] (OSE). That program features measures to improve the OSE's efficiency and efficacy, maintenance and recovery of operating costs, losses in the water supply system in the country's interior, expanding the sewer system and improving waste-water treatment. These measures will improve the framework of water and sanitation policies nationwide, thereby

complementing the measures that the present program plans to fund at the local level.

II. THE PROGRAM

A. Objectives

- 2.1 The program's objective is to improve the DGs' fiscal situation and the quality and efficiency of municipal services. The program's specific objectives are to: (a) devise instruments with which to craft and implement decentralization policies; (b) introduce an incentives system and support measures to improve the fiscal performance of the DGs and their managerial efficiency; and (c) address the investments needed for the interior departments' urban, social and economic development in an efficient and targeted manner.

B. Program description

- 2.2 To achieve these objectives, the program will fund three components: (i) sector development; (ii) departmental performance enhancement; and (iii) departmental and regional investments.

1. Sector development (US\$470,000)

- 2.3 The purpose of this component is to develop instruments that can be used to craft and implement decentralization policies. To attain these objectives, the component will feature the following subcomponents:
- a. ***Sectoral framework.*** This subcomponent will fund studies and workshops to analyze the country's decentralization process and to formulate proposals that keep decentralization moving forward. The studies and workshops will examine: (i) the revenue-sharing system; (ii) FDI regulation; (iii) the Municipal Organic Statute bill; (iv) a municipal tax ordinance model; (v) a municipal finance system; (vi) delivery and administration of local services with private sector participation; (vii) tools to encourage involvement in local government; (viii) tools that enable departments to partner with each other on delivery of services; and (ix) baseline studies for the projects' socioeconomic analyses.
 - b. ***Strengthening of the UDM.*** This subcomponent will fund activities in the following areas: (i) *project analysis and management.* Funding will be provided to hire consulting services to instruct UDM technicians in the techniques of formulating, analyzing, monitoring and evaluating projects, and to analyze and revise the manuals on preparation of investment and institution-strengthening projects; (ii) *organizational development.* Another consulting service will be contracted to review the UDM's internal structure, update its procedures and create a technical projects file; and (iii) *municipal information system.* The program will finance the design and implementation of a departmental finance and management data system, which will include a data bank on municipal

finances and a system for monitoring municipal projects. It will also feature the infrastructure needed to enable the UDM to communicate with the departmental governments and the *Congreso de Intendentes* and to make the data accessible to the public. The UDM operating costs will be covered with local contributions commencing from year four of the program.

- c. ***Strengthening the Congreso de Intendentes.*** This subcomponent will fund technical assistance to institutionalize the functions of the *Congreso de Intendentes*, including analysis of the departmental governments' service requirements, development of a strategic plan, a plan for financial self-sustainability, and an institution-strengthening program that includes an administrative re-engineering and drafting of the *Congreso's* bylaws.

2. Departmental performance enhancement (US\$6.5 million)

- 2.4 The objective of this component is to develop instruments that make the DGs' management more efficient, an objective to be accomplished by means of projects to strengthen their technical capacity and their operating systems.

a. Municipal management (US\$4.2 million)

- 2.5 This component will fund the design and implementation of procedures and systems to improve municipal management in the following areas:
 - a. *Tax administration:* measures will be taken to improve tax revenues by devising combined tax-administration systems in the following areas: (i) pre-billing of taxes; (ii) collection of taxes owed and recovery of taxes from delinquent taxpayers and tax evaders; and (iii) tax auditing.
 - b. *Financial management:* measures are planned to improve planning, curb spending, centralize financial-management data and make it more transparent by means of: (i) financial programming (rules on spending, execution of payments, and monitoring cash and bank accounts); and (ii) a combined budgetary and financial administration system (yearly and multiyear budgets, budgetary and financial formulation and execution, and budgetary, financial and asset management accounting).
 - c. *Procurement and asset management:* to realize savings on procurements and better monitor municipal assets, measures are planned in the following areas: (i) procurement and contracting procedures; (ii) materials, vehicles and property control system, and (iii) a system for physical and financial control of assets.
 - d. *Personnel management:* the objective here is more efficient allocation of personnel and to provide the tools to rationalize expenditures and make policy by developing a comprehensive personnel management system, generating a

payroll and organizing personnel files with information on entry, professional qualifications, salary history, post, and so on.

- e. *Land management*: the objective here is to provide land-planning tools by organizing geo-referenced databases (cartography, urbanism, cadastre), both geographic and alphanumeric.
- f. *Management of municipal digests*: the objective here is to make the data accessible. The component will fund a review and simplification of the legal foundation of the municipality's jurisdiction and electronic access.
- g. *Citizen services and social participation*: this subcomponent is intended to reduce the time that municipal procedures take and improve citizen services by introducing a system for monitoring administrative and fiscal procedures, systems to give the public access to legal, tax, financial, service-related and other kinds of information.

b. Cadastre and taxpayer master file (US\$1.9 million)

- 2.6 The objective of this subcomponent is to provide the DGs with an up-to-date taxpayer master file [registro único de contribuyentes] (RUC) that they can use to collect taxes and to recover taxes owed by tax evaders and delinquent taxpayers. To accomplish this, the activities conducted under previous programs will be further developed by adding data from the National Register, the National Cadastre, and departmental governments with regard to: (i) all registers a department has on vehicle licenses, urban, suburban and rural tax payments; (ii) the owner of the property listing and the corresponding addresses; and (iii) the cadastral information in these registers.

c. Training (US\$360,000)

- 2.7 Under this subcomponent, approximately 40 civil servants in each departmental government will be trained in areas of municipal management (finance, taxation, procurements, human resources, etc.) and in the techniques of managing investment projects (including project formulation and analysis and supervision and maintenance of works). The purpose is to increase productivity, lower costs and thereby deliver better service to the public.

3. Departmental and regional investments (US\$58 million)

- 2.8 This component's objective is to serve, in an efficient and targeted manner, the investments that the interior departments require for their urban, social and economic development. The component will fund projects that match the departments' socioeconomic priorities, as presented in their PAIs. The sectors eligible for funding are: preinvestment, neighborhood improvement, urban streets

and roads, environmental recovery, micro and macro drainage lines, sanitation, utilities and local economic development.

- 2.9 Other sectors consistent with the program's objectives can be added if cleared with the Bank in advance.

C. Institutional Action and Investment Plans (PAIIs)

- 2.10 Each department's investments are to be set out in a diagnostic study and an investments program laid out in the PAIIs. These plans are to contain the following:

- a. **An institutional and financial diagnostic study** of each *intendencia*, analyzing its financial performance in recent years and its key performance indicators. This diagnostic study will be the basis for determining what the desired performance indicators should be, particularly those of a fiscal nature, and which the UDM will monitor in order to evaluate the DGs' institutional performance. The PAIIs will track the following indicators, at a minimum: the fiscal period's performance, borrowing, personnel, delinquency, current balance, departmental autonomy, unit costs per service, and investment level.
- b. **The departmental performance enhancement projects** needed to accomplish the desired goals.
- c. **The investments plan**, showing the combination of investments that the *intendencias* propose for the period while the program is underway, listed in order of annual priorities.

- 2.11 The investment plan will cover a department's general investment programming, including investments funded using its own funds, funds from the PDGM IV, from the FDI and from other sources. It will be a tool for programming local public investment and be driven by the priorities set at the local level. The UDM will assist the DGs with preparation and justification of these investment plans and will coordinate the funding from this program with funding from other sources, particularly those administered by the OPP. The UDM will monitor the funds allocated, department by department, the status of execution of the institution-strengthening and investment components, and the performance indicators in the PAII. This information will be added to the municipal data system and will be available to the general public.

D. Resource allocation

- 2.12 The program's funds will be allocated under the components for "Departmental Performance Enhancement" and "Departmental and Regional Investments," according to the following criteria:

- 2.13 In the case of the Departmental Performance Enhancement component, the allocation of resources for each department will be based on a diagnostic study of the improvements needed in program-eligible areas. This allocation will enable departments to: (i) conduct strengthening projects in at least four of the seven program-eligible management areas; (ii) complete the updating and digitization of the cadastres not covered under previous programs (Canelones, Florida and San José) and put into place a taxpayer master file in every department that needs one; and (iii) become versed in internal management and investment-project management.
- 2.14 While the PAIs are being prepared, the departments will confirm which areas of strengthening they want to include in their strengthening plan, according to the following criteria: (i) the priorities must be financial management, tax management, procurement and asset management, and personnel management; other areas may be included only if the department has already fully modernized these four priority areas; and (ii) the department is not to exceed its initial allocation (see Table II-1). In the event the department either does not require or does not need to use all the funds it receives for strengthening departmental management, the unused portion may not be shifted to the investments component. The DGs are to have completed the strengthening activities in order to qualify for the second and third tranches, which will be for investment projects.

Table II-1			
Subcomponent	Resources per department¹	Total Cost¹	Eligibility
Municipal management	\$235,000	\$4.23 million	All departments are eligible for at least the four priority areas
Cadastre and taxpayer master file		\$1.91 million	
Completion of the cadastre		\$830,000	Canelones, Florida and San José
Taxpayer master file	\$60,000	\$1.08 million	All DGs are eligible
Training	\$20,000	\$360,000	All DGs are eligible
TOTAL		\$6.5 million	

¹ Values in U.S. dollars.

- 2.15 The funds for the departmental and regional investments component will be allocated among the DGs according to the formula stipulated in the budget act, which takes into account variables like population, surface area, and an inverse relationship between GDP and the number of households with UBN. The allocation of these funds among the DGs will be in three stages: in the first stage every DG

will get 50% of its percentage share, as determined by the formula prescribed by the budget act. Those DGs that have achieved the three performance indicators will receive 25% in the program's second stage (its third year) and the 25% in the program's third stage (its fourth year). In the second and third stages, the allocation will go to eligible DGs, each of which will receive the same percentage share of the total distribution that it received with the first distribution. The results of the audited municipal balance sheets for the 2005 and 2006 fiscal periods will be used to determine which DGs are eligible for the second and third tranches. A DG that fails to attain the annual targets agreed for the second tranche may receive its share of the third tranche if it attains its targeted goals.

- 2.16 **Performance indicators under PDGM IV:** The departmental performance indicators will measure the annual performance of every departmental government included in PDGM IV. Once it attains all these performance indicators, a department becomes eligible for the second and third tranches. The targeted performance indicators are the following:
- a. *Fiscal year performance.* The deficit from budget execution (total income less total expenditures over total expenditures) for the year preceding the tranche is not to exceed 5%.
 - b. *Borrowing.* The DG's debt must be fully negotiated and payment on the debt must be current.
 - c. *Personnel.* The ratio of *Intendencia* staff per 1,000 inhabitants must be less than 15. Alternatively, personnel costs must not exceed 50% of a DG's total income and (i) in any event, for DGs below the established ceilings, the indicator ratio may not be higher than 1.5 staff members per thousand inhabitants and the personnel expense indicator may not rise more than 5% above the base line or exceed the established ceilings; and (ii) likewise, for DGs that fail to satisfy either or both benchmarks established will be required to fulfill at least one indicator to be eligible for funding in the second and third stages, but may not however exceed the base line amounts.

E. Cost and financing

- 2.17 The program's total cost is US\$75 million. Of that figure, US\$60 million will be from the Single Currency Facility of the Bank's Ordinary Capital (OC); the local counterpart will cover the remaining US\$15 million. The itemized costs appear in Table II-2 below.

Table II-2. Costs of the program (US\$000 equivalent)				
COMPONENTS	IDB OC	Local	TOTAL	% TOTAL
1. Sector development	370	100	470	0.6
Sectoral framework	80	20	100	0.1
Strengthening of the UDM	160	40	200	0.3
Strengthening of the <i>Congreso de Intendentes</i>	130	40	170	0.2
2. Departmental performance enhancement	5,250	1,250	6,500	8.7
Municipal management	3,400	830	4,230	5.6
Taxpayer master file and cadastre	1,550	360	1,910	2.5
Training	300	60	360	0.5
3. Departmental and regional investments	46,800	11,200	58,000	77.0
4. Program administration	2,180	1,170	3,350	4.5
Administration and monitoring	780	820	1,600	2.1
Supervision of works	1,200	300	1,500	2.0
Evaluations	200	50	250	0.3
5. Borrowing costs	5,400	1,280	6,680	8.9
Interest	4,800	0	4,800	6.4
Credit fee	0	1,280	1,280	1.7
Inspection and supervision	600	0	600	0.8
TOTAL	60,000	15,000	75,000	100.0
Percentage by source of funds	80%	20%	100%	

- 2.18 The terms and conditions of the loan will be as follows: (i) a variable interest rate; (ii) a credit fee of 0.75% on the undisbursed balance of the loan; (iii) inspection and supervision costs of 1% of the loan total; (iv) a maximum disbursement period of five years (a minimum of three years); (v) a five-year grace period; (vi) 51 months for physical initiation of works; and (vi) an amortization period of 25 years.

III. EXECUTION OF THE PROGRAM

A. Borrower, guarantor, and executing agency

- 3.1 The borrower will be the Eastern Republic of Uruguay. The OPP will execute the program through its UDM [municipal development unit].
- 3.2 The UDM will coordinate the program and administer the loan funds, performing the following functions: (i) administer and distribute the assigned funds; (ii) monitor to ensure compliance with the terms of the contract and the Operating Regulations; (iii) assist the DGs with preparation of the PAIs and of the project-viability analyses; (iv) technically analyze the projects, check for compliance with the eligibility criteria, and approve the projects; (v) prepare the model general bidding documents and assist the DGs with preparation of the final bidding documents, approve them and, where appropriate, conduct the bidding process directly; (vi) supervise the projects' execution; and (vii) monitor for attainment of objectives and goals.
- 3.3 The UDM will be answerable to the Bank for: (i) implementing and maintaining adequate contract-, accounting-, financial and internal control systems for the program's resources; (ii) submitting disbursement requests and the corresponding justifications of expenditures, in keeping with Bank requirements; (iii) submitting semiannual Revolving Fund status reports within 60 days after the close of each six-month period; (iv) preparing and submitting the consolidated financial reports on the program and such other financial reports as the Bank may require; and (v) maintaining dedicated and separated accounts for the funds from the Bank's loan and for the local counterpart contribution.
- 3.4 The UDM will also directly carry out the activities under Component 1 "Sector Development," procurements and contracting of the consulting services planned for Component 2 "Departmental Performance Enhancement," and the contracting of the works under Component 3 "Departmental and Regional Investments," when those investments involve a group of departments.
- 3.5 *The following will be conditions precedent to the first disbursement of the financing: (i) the model participation agreement between the DGs and the Oficina de Planeamiento y Presupuesto [Planning and Budget Office] (OPP) establishing the obligations of the latter under the program on the terms agreed with the Bank, must have been submitted to the Bank; (ii) the Operating Regulations must have been implemented on the terms agreed with the Bank; (iii) the OPP must have designated the UDM as the program coordinating unit, appointed the general coordinator and the subcoordinators for the investments and institutional strengthening components and must have engaged by means of a competitive*

process an environmental specialist and a project economist for the UDM in accordance with the terms of reference agreed with the Bank.

1. UDM structure

- 3.6 The UDM will have three areas: Investments, Institutional Strengthening, and Support Sectors. The Unit will have a general coordinator and two deputy coordinators, one for the investments area and the other for the institutional strengthening area. The support sector will perform administrative and financial functions and provide advisory assistance on procurement-related or legal issues. The responsibilities and profiles of the UDM specialists are described in the program's Operating Regulations.
- 3.7 The provisions of paragraph 3.5(iii) notwithstanding, any staff hired by the UDM during the program must be selected through a competitive process and in accordance with terms of reference approved by the Bank.

2. Departmental governments

- 3.8 The DGs will be co-executors of the program and will prepare the PAIIs, contract the pre-investment studies and complete the projects' designs, conduct the tendering, contract out the works, exercise technical supervision of the works, make the respective payments, operate and maintain program-financed works or turn that function over to the competent entity. Under the component for enhanced departmental management, DGs will play an active role in the measures planned to introduce the respective recommendations into their procedures and systems.
- 3.9 *To participate in the program, the DGs must: (i) sign a participation agreement with the OPP, in the terms agreed with the Bank, wherein the Intendencias state that they have read the contract for the loan that will finance the program and will abide by its Operating Regulations (OR); and (ii) have an Institutional Action and Investment Plan (PAII) approved by the UDM and cleared by the Bank. The agreements that the UDM concludes with the DGs will feature clauses requiring the departments to: (i) submit to the executing agency an accounting of the funds received and to prepare any financial reports requested of them; (ii) keep adequate accounting and financial records of the use of the program's resources; (iii) maintain proper records of vouchers of contracts and expenditures paid with funds from the loan and from the local counterpart, which records are to be available for the external auditors and/or Bank personnel to examine; and (iv) keep separate bank accounts specifically for administration of program funds and the municipal counterpart contribution.*
- 3.10 To accede to the funds from the investment component: (i) every departmental government that received assistance under previous programs for its property tax registries must show that it is already using the newly assessed property values to

compute real estate taxes; and (ii) every departmental government must show that it is in compliance with the works maintenance policy for investments financed under previous Bank programs.

3. Specialized support agency

- 3.11 The OPP will sign an agreement with the United Nations Development Programme (UNDP), following the model agreed with the Bank, to administer the contracts under the sector development component and the program administration program, for up to US\$4 million. The contracting is to be done according to Bank policy. The UNDP is already under contract to perform these functions for the executing agency of the PDM III, an arrangement that has significantly expedited the service contracting for that program. The services will include the contracting of the consultants needed to assist with program execution and technical supervision. The UNDP will be hired out of the local counterpart contribution. *A condition precedent to the first disbursement is that the agreement between the UNDP and the OPP spelling out their obligations under the program, is signed and in effect.*

B. Project execution and administration

1. Sector development

- 3.12 The UDM will prepare the bidding documents for the selection and contracting of the consulting services and will monitor and technically supervise the activities conducted under this component. The contracting of studies and organization of decentralization-related workshops will be done in the program's first three years, following a plan of action that establishes what the priority issues and workshops will be, the principal content, the timetable for their execution and the corresponding costs. This work program must be the product of a consensus with the Decentralization Commission. The UDM will hire the consulting services for strengthening of the *Congreso de Intendentes*, with the latter's active participation.

2. Departmental performance enhancement

a. Municipal management

- 3.13 In conjunction with the DGs, the UDM will select a group of departments for the first call for bids on the consulting contracts to assist with implementation of the institution-strengthening activities. This bidding will be in the program's first year. Once the consulting firm has been selected and the consulting activities are well underway, the UDM will review the original terms of reference and announce one or more calls for bids on the consulting contracts for the remaining departments.
- 3.14 The firm selected in the bidding process will review the main procedures that each department uses in the program-eligible management areas, introduce new procedures and prepare a procedural manual for each department.

- 3.15 For each *intendencia*, the consulting firm will develop a short- and medium-term data processing master plan. The DGs will prioritize the following areas of municipal management: tax administration, financial management, procurements and assets, and personnel. Those departments that have already made investments in these areas and whose systems are sufficiently well developed, may opt to work on other eligible municipal management areas instead (land management, municipal digests, citizen services and social participation).
- 3.16 Once the procedures have been reviewed, the data processing plan has been established and the software systems for four management modules have been developed, the firm will supply the basic hardware and software for the proposed new procedures and will train the staff of the *intendencias*.

b. Cadastre and taxpayer master file

- 3.17 Departments interested in establishing a taxpayer master file (RUC) are to sign agreements with the regional offices of the *Dirección General de Registros* (National Register) and of the *Dirección General de Catastro Nacional* (National Cadastre) wherein the institutions undertake to cooperate and keep the RUC data current after the program's activities have concluded. The departments will contract for the RUC or may request that the UDM do the contracting itself. For any department to accede to the funds under the cadastre and taxpayer master file subcomponent, the agreements that the departmental government is to sign with the National Register and with the National Cadastre, in the terms agreed with the Bank, must be in force.
- 3.18 The sequence of activities under this component will include the following: (i) survey, digitization and indexing of all departmental registers relating to movable assets, vehicles, and real estate (urban, suburban and rural); (ii) survey, digitization and indexing of the information on the owner of the property listing with the corresponding addresses; and (iii) geo-referencing of the graphic databases on real estate properties.

3. Departmental and regional investments

- 3.19 The departmental and regional investments component will follow the following sequence:

a. Identification of projects

- 3.20 The DGs will prepare a PAII where they will identify investments in their departments and rank them in order of priority. The investments will also include those whose funding will come from other sources such as specific budgets of line ministries, and so on.

b. Preliminary consultation and feasibility

- 3.21 Following the guide for project formulation, the DGs will prepare a project profile for preliminary consultation on any investment project. Once the profile is reviewed the UDM will give the DG an official answer as to whether the project is eligible, the corrections needed to bring the project concept in line with program standards, the studies that are missing, and the requirements that the *Intendencia* will have to meet.

c. Project viability analysis and approval

- 3.22 The UDM will review the projects to check for compliance with the eligibility criteria. That review will be reported in detail in a project analysis report (PAR) prepared by a technician and containing a suggested project ranking. A committee composed of the UDM coordinator, the technician who prepared the report, the UDM's economist and its environmentalist will discuss the PAR. For projects that will require clearance by the organ with jurisdiction or future operator—the OSE, for example, in the case of sanitation projects—the necessary documents will have to be submitted to the UDM.

d. Execution of projects

- 3.23 **Bidding.** Every project in the program will be awarded through local or international competitive bidding (see section D of Chapter III). The bidding will be done using model bidding documents, agreed with and cleared by the Bank in advance. Bids on the construction works must include a quotation for an expansion option, which may or may not be awarded during execution, depending on what the UDM and the Bank authorize.
- 3.24 **Award.** Once the bidding on works contracts, procurements and service contracts associated with UDM-approved projects has been completed, but prior to the award of same, the municipal governments will submit the pertinent documentation to the UDM and/or the Bank for clearance, according to whether the amounts involved fall above or below the thresholds given in Section D of Chapter III of this report
- 3.25 **Supervision of works.** The DG will supervise the construction work, making certain that the contractor adheres to the bidding specifications and carries out the environmental management plan (EMP). The UDM will also contract outside supervision of the works. The UDM and other bodies with authority may visit the work sites at any time to check that specific measures are being implemented.
- 3.26 **Cost overruns and extensions on construction deadlines.** Before construction cost overruns of over 10% can be authorized, an economic analysis must be done showing that the project's incremental return is 8% or higher. The supporting documents to authorize the cost increase must be included in the project file. When the increase is due to *force majeure* (floods, excessive rains, disturbances, etc.), the

competent agency may, at its own discretion, authorize the increase without requiring the additional economic analysis.

e. Certification and acceptance of works

- 3.27 With the endorsement of the Director of Works and UDM Supervisor, the *Intendencia* will prepare the acceptance certificate. Once the firms contracted to carry out the projects have completed the construction work, the *intendencia* will proceed to take delivery of same (after obtaining the UDM's clearance) and will certify its acceptance in a document drawn up for that purpose.
- 3.28 The *Intendencia* must also order the measures necessary to put the works into operation and maintain them in the future. In the case of sanitation works, the completed construction is to be transferred to the OSE Administration, which will take delivery of the works and certify its acceptance, as stipulated in the requisite pre-existing agreement between the OSE and the DGs.
- 3.29 *A condition precedent to execution of the sanitation construction works will be that the agreements that the departments must sign with the OSE concerning the handover of those works must have already been signed. The agreements in question will be drafted on the terms agreed with the Bank.*
- 3.30 In the case of works that will transfer to the private sector for operation, the contract that the DG and the private operator will sign (which must have UDM and Bank clearance) will set out the terms regarding operation and maintenance of the works. The private operator selected will be required to cover all operating and maintenance expenses.

f. Operation and maintenance

- 3.31 When the *Intendencia* takes delivery of the construction works from the contractors, it will certify its acceptance in a document prepared for that purpose. The *Intendencia* will also order the measures needed to put the works into operation and to maintain them, including environmental monitoring when so stipulated in the EMP. In the case of sanitation projects, the works will transfer to the OSE, which will take delivery and certify its acceptance, as required under the terms of the OSE/DG agreement.

g. Eligibility criteria

- 3.32 The principal eligibility criteria for program-financed projects are detailed in Table III-1. The detailed eligibility criteria appear in the program's Operating Regulations.

Table III-1: Eligibility Criteria

Sector	Technical	Economic	Environmental
NEIGHBORHOOD IMPROVEMENT	The least-cost solution and construction option is to be chosen. The only sanitation projects included will be those that meet the sector's technical requirements—see corresponding criteria—and that represent less than 70% of the total value of the investment.	An EIRR greater than or equal to 12% and an FIRR greater than or equal to 8%. Water supply and sanitation projects must meet the Bank's criteria for the sector.	The neighborhood must plan solutions to the problems of trash collection and sanitation. For drainage works, it must mitigate the impact at the outfall. Implement the EMP.
URBAN STREETS AND ROADS	Traffic counts and other traffic-related information must be available. The project's functionality should be examined by comparing the existing systems of streets and roads with the one planned. The least-cost solution must be selected. In the case of construction works that form or link systems, care must be taken to connect them with existing entrances and exits.	An EIRR greater than or equal to 12% and an FIRR greater than or equal to 8%, provided the latter is higher than the Bank's semiannually adjusted OC.	Include storm sewers. Consistency with the Land Development Plan. Mitigate adverse effects on neighbors. Bridges with adequate access ramps and safe for both vehicular and pedestrian traffic. Implement the EMP.
ENVIRONMENTAL RECOVERY AND SANITATION	The technical design of the water supply and sanitation projects must be approved by the sector's legal unit and conform to the Bank's guidelines for the sector. Sanitation projects must link up with existing sewer mains and plan for proper treatment and final disposition. The projects must include hook-up of potential users.	An EIRR greater than or equal to 12% and an FIRR greater than or equal to 8%, provided the latter is higher than the Bank's semiannually adjusted OC. Provision must be made to recover costs through tariffs or some other mechanism.	Locate the treatment plant in a zone where it will not be a nuisance to neighbors and mitigate other negative effects. Take into account the receiving body of water's capacity to absorb. Preliminary Environmental Authorization and submit environmental impact assessment (EIA). Implement the EMP.
MICRO AND MACRO DRAINAGE LINES	An analysis of the watershed must be presented, as must an analysis of how volume and flow vary as a result of the project, within its boundaries and beyond.	An EIRR greater than or equal to 12% and an FIRR greater than or equal to 8%, provided the latter is higher than the Bank's semiannually adjusted OC.	No wastewater in the pipelines. Mitigate the effect at the outfall point. Adequate urban solid-waste collection systems. Implement the EMP.
URBAN UTILITIES	In the case of solid waste, the waste-management plan prepared or consolidated for the <i>intendencia</i> must represent a comprehensive service solution, ensure recovery of costs and, in particular, consider outsourcing the service or parts thereof.	An EIRR greater than or equal to 12% and an FIRR greater than or equal to 8%, provided the latter is higher than the Bank's semiannually adjusted OC. Solid waste: minimum cost solution (benefits per sums paid to beneficiaries).	Budget for operating staff's training. Submit preliminary environmental authorization and the EIA in the case of sanitary landfills. Implement the EMP.
LOCAL ECONOMIC DEVELOPMENT	The designs conform to generally accepted local standards and norms or, absent that, international standards and norms. The designs conform to the regulations in force on land use and other provisions.	An EIRR greater than or equal to 12% and an FIRR greater than or equal to 8%, provided the latter is higher than the Bank's semiannually adjusted OC. A market study.	Prepare Preliminary Environmental Authorization and, whenever necessary, the EIA, and implement the EMP.

C. Municipal contribution

- 3.33 The DGs will be required to contribute their own funds to the program, in addition to the local counterpart funding, according to the following breakdown: (i) Institutional Strengthening Projects: contribution of zero; (ii) Local Economic Development Projects: a contribution of 10%; and (iii) other investment projects: a contribution of 20%. The UDM will be responsible for analyzing and approving the municipal contribution provided by the DGs, which will require the Bank's nonobjection.
- 3.34 Land, construction materials, works that complement the program-financed project and the preinvestment expenses against billing will be counted toward the municipal contribution. The UDM will analyze and approve what the departments will offer toward their municipal counterpart. The Bank's nonobjection will be required.

D. Procurement of goods and services

- 3.35 Contracts for works and services and procurements under the program will be done in accordance with Bank procedures. International competitive bidding will be required for works contracts equal to or greater than US\$2 million, procurements equal to or greater than US\$350,000, and consulting contracts equal to or greater than US\$200,000.
- 3.36 As stipulated in document GN-1679-3, price may be used as the criterion for selecting the consulting service. If a combination of price and the quality of the technical proposal is the criterion used to select consulting firms, the relative weight assigned to price may not exceed 20%, and that assigned to the technical quality of the proposal may not be less than 80%.
- 3.37 The thresholds for autonomous UDM approval of projects will be US\$80,000 for procurements of goods and contracting of related services, including consulting services; and US\$500,000 for construction works. The Bank will take a random sample for an ex post review of the bidding documents and procedures used in these cases.
- 3.38 The tentative procurement plan for the program is attached as Annex III-1.

E. Recognition of expenditures

- 3.39 Up to the equivalent of US\$200,000 in expenses incurred within the 18 months prior to the date of loan approval and associated with the UDM strengthening activities, studies for the economic analysis and preparation of the program's baseline, can be recognized as part of the Bank financing, provided the contracting and procurement procedures followed are substantially similar to the Bank's procedures.

F. Execution period and disbursements timetable

- 3.40 The execution period for the program will be five years, as shown in the following tentative disbursements timetable:

Table III-2 DISBURSEMENTS TIMETABLE US\$000 equivalent						
SOURCE	2004	2005	2006	2007	2008	TOTAL
IDB/OC	8,000	8,000	12,000	16,000	16,000	60,000
Local	2,000	2,000	3,000	4,000	4,000	15,000
Total	10,000	10,000	15,000	20,000	20,000	75,000
% / Year	13%	13%	20%	27%	27%	100%

G. Monitoring and evaluation

1. Monitoring reports

- 3.41 The program will be monitored by means of progress reports prepared by the UDM and submitted to the Bank within 60 days after the end of each calendar six-month period.
- 3.42 To monitor the indicators of departmental performance, the initial report on the program will include the baseline indicators and the goals set for the 18 DGs. The report is to include, as a minimum, the indicators measuring the departments' annual performance and those that figure in the PAIIs (fiscal year performance, borrowing, personnel, delinquency, current balance, municipal autonomy, unit costs per municipal services, and investments level).
- 3.43 The progress reports for the second calendar six-month period are to include an annual plan of operations (APO), showing the projections for the program's end. The APO's benchmarks will be the goals established in the program's logical framework (Annex III-2). This report will also monitor for attainment of the goals set for each department and the departmental performance indicators included in the program and in the PAII. For each program component, the semiannual report will analyze the progress made and activities completed, reporting the results obtained, goals achieved, problems encountered and corrective action proposed.
- 3.44 The financial reports, audited by the *Tribunal de Cuentas* (Official Auditing Office), will be submitted to the Bank within the 120-day period following the close of each economic period. A final audited financial statement, illustrating how the funds received were used, will be submitted 120 days after the last disbursement is made.

2. Annual reviews

- 3.45 Working from the second semiannual progress reports, the executing agency and the Bank will conduct reviews of the program during the first quarter of each year, to examine the progress made. The reviews will be an opportunity to analyze program execution, check the development of the departmental performance indicators, and agree on the annual plan of operations for that year. During these reviews, the Bank will also check to determine whether funds for the program are available in the budget and local contribution.

3. Evaluation of the program

- 3.46 *The UDM is to submit the program's baseline to the Bank nine months from the date of the loan contract.* The UDM is currently contracting services to build the baseline, which will rely on existing sources of municipal information such as the (i) Continuous Household Survey (ECH);⁵ (ii) the National Census;⁶ (iii) the UDM's municipal data system; (iv) departmental budgets; and (v) the *intendencias'* audited balance sheets. The study will also supply the following information: (a) unit costs per category of municipal works (trash collection and cleaning, street lighting and construction and maintenance of urban streets and roads); and (b) registered real estate values from all interior departments.
- 3.47 In addition, in order to calculate the remaining program indicators, nine months after the effective date of the loan contract *the UDM will submit to the Bank the results of the hedonic price studies for projects in neighborhood improvement, drainage works and other categories for the interior departments.*
- 3.48 *The UDM will submit a midterm evaluation contracted with an independent external institution, 30 months after the effective date of the loan contract or when 50% of the program's funds have been disbursed, whichever comes first.* This evaluation will examine: (i) the results achieved for each program component; (ii) accomplishment of the goals established in the logical framework; and (iii) adherence to program procedures. It will also single out any problems and bottlenecks that arise during execution and will propose corrective measures for the remainder of the program. The cost of this evaluation is included in the program's financing.
- 3.49 It was agreed that the borrower will finance an ex post external evaluation of the program. Six months after the date of the last disbursement, the borrower, by way of the executing agency, will submit to the Bank a final evaluation report prepared

⁵ The ECH is representative at the national level and includes data on household income nationwide, as well as the municipal utilities' coverage indicators.

⁶ The census data are used as the basis for charting the poverty maps and figuring the indicators of unmet basic needs (UBN).

by an independent outside institution, which contains the various results of the program. The report will be prepared using the information utilized in the semiannual reports and in the midterm evaluation, and any additional information needed to do the evaluation and a methodology similar to the one that is used for the ex ante analysis will be followed. It will cost an estimated US\$50,000.

4. Bank supervision

- 3.50 The Bank's Country Office in Uruguay will supervise the program. Particular attention will be paid to compliance with the terms of the Operating Regulations for preparing and carrying out projects and the terms for municipalities' eligibility. At the end of each calendar year, the Bank, through its Country Office, will hire a specialized consulting firm to technically monitor the program, particularly whether the procedures established for the analysis, bidding, contracting and supervision of works and institution-strengthening projects are being observed, and whether the studies and workshops proposed under the sector-development component are being conducted. The monitoring will also check how the new UDM procedures are functioning and whether the file is being properly maintained.

H. Revolving fund

- 3.51 Given the decentralized execution of the program, which is spread among 18 departments, a revolving fund will be set up for no more than 10% of the loan amount and for the purpose of funding advances out of the financing.

IV. VIABILITY AND RISKS

A. Analysis of the program's viability

- 4.1 The analysis of the program's viability focuses on the following: (i) the execution capacity of the institutions involved in the program; (ii) the viability of the institution-strengthening projects, and (iii) the technical, financial, economic, social and environmental viability of the investments projects.

1. Institutional viability

- 4.2 The Municipal Development Unit (UDM) of the Executive Branch Planning and Budget Office was responsible for execution of the Municipal Works Program (POM) II and the Municipal Development Program (PDM) III and for preparation of this program. The unit has a total of 15 consultants, distributed among the institution-strengthening and investments coordination offices and administrative, financial and administrative support office. It has the experience needed to conduct this fourth phase.
- 4.3 The departments in the country's interior have successfully discharged their functions as co-executors of the earlier programs. The departments have a demonstrated capacity to call for bids, contract, supervise, operate and maintain the works of the program. As explained in Chapter I, the weakest aspect of the departmental administrations is their internal administrative systems, particularly the financial and fiscal management systems. This will be strengthened by: (i) upgrading the internal management instruments, which will lower costs and increase revenues; and (ii) establishing an incentives system to ensure the departments' fiscal equilibrium. The departmental governments (DGs) have been involved in the program's preparation, through a workshop of stakeholders attended by all the *intendentes* and their officials, a meeting with the *Congreso de Intendentes* to define and confirm the activities that will be held to assist with organization, and a number of meetings with groups of *intendentes* to determine what the institution-strengthening and investment needs are. At all these events, the *intendentes* reiterated their endorsement of the program's design.

2. Technical, socioeconomic, and financial viability

a. Projects in departmental performance enhancement

- 4.4 The design and feasibility analysis of the institution-strengthening projects began with an ex post evaluation of the institution-strengthening projects conducted under previous programs and an individual diagnostic study of the internal management problems in a sample of eleven departments in the interior. Questionnaires were circulated and interviews conducted with the *intendentes* and the technical teams

from these departments. The UDM team later expanded this procedure to cover all the departments.

- 4.5 As mentioned in Chapter I, the lessons learned from previous programs have been internalized to ensure that by the end of this fourth phase, all the interior departments will have achieved similar levels of expertise in the principal areas of internal management. To that end, the diagnostic study focused on the areas of tax administration, financial management, personnel, procurements and assets, records management, land management, management of municipal digests, citizen services, social participation and information technology. This diagnostic study pinpointed the priority areas in need of strengthening in each department. Priority was assigned to requirements in the areas of finance, taxation, personnel and asset management. The corresponding consulting plans were scaled accordingly and their terms of reference prepared. These will be used as the basis for contracting consulting services for each department.

b. Investment projects

- 4.6 The following was done to examine the technical, socioeconomic and financial feasibility of the investment projects: (i) an ex post evaluation of a sample of projects funded under PDM III; and (ii) an ex ante assessment of another sampling of projects proposed for this program. The sample of projects from the previous program included eight investment projects that represented 27% of the total investment made and whose principal economic features, amounts and execution periods are summarized in Table IV-1. A total of US\$16 million was invested in the ex post sample, with an average of US\$1.9 million per project. The principal findings of the ex ante analysis of the sample of projects that figure in the present program appear in Table IV-2.
- 4.7 **Technical issues.** All the projects analyzed in the ex post and ex ante samples are relatively simple works involving urban streets, roads, sidewalks, bridges, sewers and other forms of sanitation, community and other urban services and facilities that improve the neighborhoods. The quality of the local engineering is adequate. However, the ex post analysis found that the quality of the pre-investment studies needs improvement, since the average ex post IRR under the previous program was not even 10%, even through the UDM's ex ante estimates had predicted an average IRR of 14.7%. In addition, the execution periods under PDM III had to be extended, which were 95% longer than the time period established in the original contract.

Table IV-1 Ex post evaluation: sampling of pdm iii projects				
Project / sector	Amount in US\$ thousands (1)	Ex ante IRR (2)	Ex post IRR (3)	Negative of: [(3)/(2)] - 1 (4)
Improvement for Las Piedras [Obelisco Barrio]	2,160	12.1%	12.4%	- 2.1%
Downtown streets, Artigas	1,738	17.6%	14.7%	16.8%
Regularization Sauzal Stream in Salto	2,716	8.0%	7.4%	7.3%
Storm sewers in Paysandú	4,382	20.0%	14.4%	29.7%
Urban integration of Fray Bentos	1,760	7.2%	1.0%	86.0%
Colonia del Sacramento bus terminal	1,328	22.3%	7.4%	72.6%
Improvement southern Minas	942	17.9%	10.8%	39.5%
Durazno bus terminal	873	11.7%		
SIMPLE AVERAGE	1,987	14.7%	9.7%	34.8%

- (1) Includes cost overruns.
- (2) Readjusted for methodology.
- (3) Reajusted for changes in costs and benefits vis-à-vis the original assumption.
- (4) Degree to which the original value was overestimated.

4.8 **Socioeconomic considerations.** The disparities in the ex post return on the investments is due both to the flawed methods used to calculate the ex ante estimate, and to the actual course of the investments' execution, i.e., overruns in both the investment costs and execution periods. Therefore, conceptual, instrumental and organizational aspects of the ex ante analysis process have been improved for this program, as has the focus of the economic analysis and of the investment tendering process. The specific measures that the present program adopts to ensure an adequate return on the investments and avoid the enormous disparity between the ex ante and ex post analyses are: (i) development of standardized analytical tools for all projects or categories of projects (hedonic price studies to determine typical real estate assessment coefficients and calculation of the shadow prices to analyze benefits and costs consistently); (ii) the improvement in the projects' design by including pre-investment as a category eligible for funding; (iii) establishment of criteria and procedures to eliminate the time and cost overruns on the original contracts; and (iv) adjustment of the cut-off rate of acceptable minimum return to match the opportunity cost of public funds in Uruguay.

4.9 As for the sample of projects for the PDGM IV, the costs of the projects whose basic designs were examined were inflated. After scaling back the costs to match proposed coverage levels, the projects show an average financial internal rate of

return in excess of 8%. To authorize the respective calls for tenders, however, the OPP will have to check that the resizing and evaluation of the sample once the designs are execution-ready yield an economic internal rate of return (EIRR) of 12% or higher and a financial internal rate of return (FIRR) of 8%, provided this is higher than the Bank's semiannually adjusted OC rate; in other words, efficiency cost solutions, whenever appropriate.

Table IV-2
Results from the Sampling of Projects

Sector / project	Invest. (000 US\$)	Households Benefited		FIRR (%)	Financial Sustain.
		No.	UBN (%)		
Neighborhood improvement					
Street lighting LP	224	970	37	11.5	+Δ tariffs and contributions
Imp. Hosp. Zone LP	973	195	37	8.0	
Barrios Souza TM	800	500	58	11.9	
Barrio 9 Melo	1,222	601	52	10.5	
Urban services					
Outsource cleaning and trash collection	310	7,000	52	Least cost	-Δ 33% cost
Environmental Protection and Sanitation					
Shoreline protection, San Gregorio de Polanco	826	750	50	8.0	+Δ contributions
Local Economic Development					
Agrifood business park	1,753	N.A	N.A.	>8%	-Δ maint costs urban plant
TOTAL	6,108	9,266			
Environmental briefs have been done on all the projects					
UBN – Unmet basic needs are those that do not have drainage pipes.					

3. Environmental and social viability

- 4.10 The investments made under the program will have positive environmental and social effects, but that will differ for each sector. They will include the following: (i) an improved quality of life and better health indicators, associated with the execution of the sanitation, storm sewer and comprehensive solid waste management projects; and (ii) the improved environmental situation in the departments by restoring degraded areas, controlling erosion and sedimentation, eliminating environmental liabilities, establishing parks and green areas, and strengthening the DGs' environmental management.
- 4.11 On the other hand, the program can cause negative environmental and social effects, though they will be confined to the period during which program financed

works are under construction. The experience of the previous programs has shown that these are common, localized and reversible effects. The typical kinds of measures to offset these effects appear in Table III-1. The ex post environmental evaluation of PDM III concluded that the environmental procedures applied while the project was underway either eliminated or mitigated most negative effects. However, some minor problems have been cited, most caused by the fact that for the last three years of the previous program the UDM did not have an environmental specialist on staff. For the environmental assessment of the new projects contained in Table IV-2, the *Dirección Nacional de Medio Ambiente* (DINAMA) has only requested a preliminary environmental authorization and an environmental impact study. Independently of whatever procedure DINAMA performs, every project in PDGM IV will follow an environmental procedure that requires, *inter alia*, specific environmental evaluations and a duly budgeted environmental management plan, submitted by the contractor prior to the physical initiation of the works.

- 4.12 The environmental and social management plan (ESMP) is built into the program, particularly by way of the Operating Regulations. Internalizing the lessons learned from the ex post environmental evaluation and the environmental assessment of the sample of new projects, an effort has been made to find new ways to strengthen environmental management under the PDGM IV. As a result of this effort, a number of adjustments have been made to the new Operating Regulations, and the UDM will be bolstered with the addition of an environmental specialist. Improvements have also been made to: (i) the flow of preparation, design, evaluation, approval, inspection and environmental monitoring in the guide to project formulation and presentation; (ii) the general and specific environmental eligibility criteria; and (iii) the UDM's new technical archives system. Adapted to suit the specifics of each DG's plan, the environmental theme will be included in the PAII and in the Land Management module under the Municipal Management and Training subcomponent.
- 4.13 The operation qualifies as a social-equity enhancing program, as described in the key objectives set forth in the Report on the Eighth General Increase in Resources (document AB-1704). If the trend observed in the previous program holds up, the bulk of the investments made under this program will be in the neighborhood-improvements sector.
- 4.14 The operation also qualifies as a poverty-targeted investment (PTI). According to the projected demand and the features of the sample projects in the present program, assuming the projects preferred by the *intendencias* are funded, 50.5% of the beneficiary households will be in areas with UBN. The borrower will not be using the additional 10% financing.

B. Benefits

- 4.15 The principal benefits from the PDGM IV will likely accrue from the interior DGs' improved fiscal and tax-management practices, brought about by the incentives that the program will introduce to attain the fiscal and financial goals and by the technical support provided under the program. Once they have been strengthened, the *intendencias* are expected to increase their savings capacity, generate revenues that can be used for additional investments and for proper maintenance of the works already built, thereby improving the quality of their utilities.
- 4.16 The change in the formula used to allocate the funds from this program and from the Interior Development Fund, which will now include variables related to the inverse relationship between per capita GDP and households with UBN, will help achieve greater horizontal equity among the municipalities in the interior.
- 4.17 Direct benefits are also expected to accrue from the physical investments, which represent more than 80% of the program's expenditures. Based on the sample prepared for this program (see Table IV-3), the program is expected to benefit, either directly or indirectly, an estimated 95,000 households; of these, 48,000 would be in areas with UBN.
- 4.18 The ex post evaluations done of earlier projects found that for the projects in the sample, a significant portion of the benefits accruing to the families as a result of the construction work will be the higher urban property values.⁷ The appreciation can range anywhere from 30% to 70%, and it is on the basis of this anticipated appreciated value that the eligible projects show internal rates of return between 10% and 20%.

C. Risks

- 4.19 Uruguay's economic problems were exacerbated by Argentina's economic and financial chaos, as real GDP fell by 10.8%. Given the situation, the government implemented a number of fiscal adjustments under successive agreements with the International Monetary Fund (IMF), the most recent of which was signed in March 2003. One of the principal risks of this operation is associated with the cutback in public spending needed to achieve, in 2003, a primary surplus of 3.2% of GDP and a reduction of the fiscal deficit to 3.1% of GDP. What this means for the program is that the budgetary appropriation might be smaller, which could slow program execution.

⁷ The improvement in the beneficiary families' quality of life is the result of two factors. The first is the income effect—added consumption—that follows from the increased assets of the poor (neighborhood improvement), while the second is an improved standard of living (greater security, cleanliness, health, and access to transportation) that is proportional to the value of the land.

- 4.20 The team reviewed the budgetary appropriations for departmental revenue-sharing planned in the projections prepared by the OPP under the IMF agreement. The size of the program takes into account the fiscal limitations that these projections anticipate. The disbursements planned for 2004 and 2005 have been scaled back accordingly. The Bank will have to remain in constant contact with the Central Government to be certain that the annual appropriations match the program's execution timetable.
- 4.21 The change in the central government that will take place in March 2005 could bring about priority shifts in relation to the programs underway at that time. This risk is fairly neutralized in the case of the PDGM IV, as the program is part of a political commitment between the central government and the departments regarding revenue sharing. The revenue sharing, in turn, is guaranteed under the Five-Year Budget Act, which will still be in force in the new administration's first year in office.
- 4.22 Significant fluctuations in the exchange rate could skew the projects' analysis and the tendering, albeit in differing ways.⁸ Therefore, with this operation a new, de-dollarized database will be created for project analysis and bidding prices. Also, a polynomial formula is being created to make any necessary adjustments to the bids offered.
- 4.23 Another possible risk is that some *intendencias* might fail to achieve the fiscal and budgetary goals that the program has proposed for the end of the second and third years. This would prevent them from acceding to the last disbursement of funds, which in turn would compromise the goal of equitable attainment of development objectives. To counter this possibility, the program features financial incentives (the funds are distributed to the *intendencias* that achieve the targets) and the tools needed to achieve these goals, such as instruments for financial control, increased tax revenues and others calculated to improve the municipalities' capacity for savings and investment.
- 4.24 Given the turnover of *intendentes* while the program is in progress, incoming municipal governments may have different priorities, which could compromise the commitment to balance municipal accounts. However, the consensus built at the workshop of stakeholders held during preparation of the operation and at various meetings held with the *intendentes* and the *Congreso de Intendentes*, and the Institutional Action and Investment Plans (PAII), which provide for a closer relationship and constant monitoring, reduce the likelihood of changes being introduced in the agreements signed.

⁸ For the duration of the PDM III, the currency used was the United States dollar and it is the currency used for the financial analysis and the bidding process.

TENTATIVE PROCUREMENT PLAN

PRINCIPAL PROCUREMENTS	SOURCE OF FUNDS	TOTAL AMOUNT (thousands)	PROCUREMENT METHOD	ESTIMATED TIMING
Component 1: sectoral development				
10 consulting contracts at an average cost of US\$50,000	80% IDB 20% Local	US\$470	LCB	2004/2006
Component 2: departmental performance enhancement				
8 management-systems consulting contracts at an average cost of US\$820,000	80% IDB 20% Local	US\$6,500	ICB	2004/2006
Component 3: departmental and regional investments				
58 urban, social and economic development works at an average cost of US\$1 million ICB will be used for works > US\$2 million	80% IDB 20% Local	US\$58,000	LCB/ICB	2004/2008
LCB - Local competitive bidding ICB - International competitive bidding				

**MUNICIPAL DEVELOPMENT AND MANAGEMENT PROGRAM
(UR-0131)
LOGICAL FRAMEWORK**

OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
GOAL Improve the well-being of the population in the interior.	A reduction in the percentage of families in the departments outside the metropolitan area identified as having unmet basic needs (UBN). An increase in the coverage of municipal services like street lighting, paving of streets and roads, and trash collection.	Continuous Household Survey (ECH), National Census, reports from the Planning and Budget Office (OPP) and ex post evaluation.	Macroeconomic stability.
PURPOSE Improve the fiscal situation of the departmental governments (DGs), upgrade the quality of municipal services and make their delivery more efficient.	<ol style="list-style-type: none"> 1. Ten (55%) of the interior departments attain the following targets by the program's midway point, and 13 (72%) by the program's end. <ol style="list-style-type: none"> a) A budget-execution deficit (total income less total expenditures divided by total expenditures) of 5% or less. b) Stock of debt totally negotiated and paid up to date c) Ratio of departmental personnel per 1,000 inhabitants is under 15, or the ratio of personnel costs to total expenditures is at or under 50%. 2. An increase in the municipalities' net investment capacity. 3. Lower unit costs by type of municipal service (trash collection, cleaning, street lighting, construction and maintenance of streets and roads). 	<ol style="list-style-type: none"> 1.1 The program's progress reports 1.2 Reports produced by the municipal development unit's data system. 1.3 2005 and 2006 audited balance sheets. 2.1 Program reports 2.2 Intendencias' yearly budgets 3.1 Survey reports comparing costs before and after the program. 	The turnover of <i>intendentes</i> and technicians has no significant effect on the program's continuity. Sustained growth of GDP in the departments outside the metropolitan area. The necessary investment have been made in areas identified as having UBN.

OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<p>COMPONENTS</p> <p>1. Sectoral development</p> <p>Tools instrumental in crafting and implementing decentralization policies are developed and sectoral institutions (UDM and <i>Congreso de Intendentes</i>) are strengthened.</p>	<p>4. Changes in initial conditions of the population targeted by the program (i.e. in security, sanitation, employment, etc.).</p> <p>1.1 At least five studies and/or proposals completed in the following areas: (i) financing and revenue-sharing system; (ii) regulation of the Interior Development Fund; (iii) municipal organic statute and municipal tax ordinance, and (iv) instruments for the socioeconomic analysis of projects.</p> <p>1.2 Information on municipal/ departmental finances and performance is available to the public by the end of the second year.</p> <p>1.3 By the end of the first year, all technical staff in the UDM projects area are trained in how to formulate, analyze, monitor and evaluate projects.</p> <p>1.4 With at least 50% of the investment projects, the economic internal return rate (EIRR) shown by the ex ante evaluation is very similar to the EIRR obtained after the annual reviews and evaluations</p> <p>1.5 Regulation of the <i>Congreso de Intendentes</i> underway.</p>	<p>4.1 Program reports</p> <p>4.2 Midterm and ex post evaluations</p> <p>4.3 Surveys</p> <p>1.1.1 Program reports.</p> <p>1.1.2 Technical studies.</p> <p>1.2.1 Data system implemented at the UDM</p> <p>1.2.2 Reports prepared.</p> <p>1.3.1 Training reports.</p> <p>1.4.1 Annual reviews</p> <p>1.4.2 Midterm evaluation.</p> <p>1.4.3 Final evaluation.</p> <p>1.5.1 Bill regulating the article of the Constitution is introduced in the Congress.</p> <p>1.5.2 Congreso's draft bylaws introduced.</p>	<p>Anticipated annual budgetary appropriation untouched.</p> <p>The departments make a commitment to improving management and have and put up the counterpart funding needed to carry out the projects funded by the program, either in the form of a financial contribution toward investment projects or the contributions needed for the institution-strengthening projects.</p> <p>The bidding process is completed by scheduled deadlines</p> <p>The DGs enforce payment of delinquent accounts.</p>

OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<p>2. Departmental performance enhancement</p> <p>The performance of the interior departments is made more efficient.</p>	<p>2.1 Integrated management systems in the four priority modules (financial management, tax administration, procurement and assets, and personnel) implemented in all the departments by the end of the third year.</p> <p>2.2 100% of municipal taxpayer master accounts (RUCs) financed under the program are functioning by the end of year three.</p> <p>2.3 By the end of the third year, all the <i>Intendencias</i> are levying taxes based on the new assessed property values.</p> <p>2.4. Tax delinquency in departments that have installed the RUC are down by 50% by the end of the program.</p> <p>2.5. By the end of the third year, municipal technicians have received instruction in subjects related to municipal management and investment projects.</p>	<p>2.1.1 Institutional action and investment plans (PAIIs), UDM report matches Annual Plan of Operations (APO)</p> <p>2.1.2 Field visit.</p> <p>2.2.1 PAII, UDM report comparing performance with the APO.</p> <p>2.2.2 Field visit.</p> <p>2.3.1 Field visits to the departments.</p> <p>2.3.2 Reported cadastral values consistent with the market value of the land.</p> <p>2.4.1 PAIIs, UDM reports on tax delinquency levels in the departments.</p> <p>2.5.1 Attendance records.</p> <p>2.5.2 Training manuals submitted.</p>	
<p>3. Departmental and regional investments</p> <p>The investments that the interior departments require for their urban, social and economic development are made efficiently and well-targeted.</p>	<p>3.1 By the end of the program's first year, 18 <i>intendencias</i> have decided on their investment plan for the next five years and have ranked their planned investments in order of priority, and have an institutional and financial diagnostic study.</p>	<p>3.1.1. 18 PAIIs approved by the UDM.</p>	

OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
	<p>3.2. By the end of program execution, at least 70% of the investment projects show an EIRR \geq 12% and a FIRR \geq 8%.</p> <p>3.3. At least 50% of the investments are in areas where at least one half of the population have UBN.</p> <p>3.4 A 20% reduction in the cost of outsourced urban services in projects financed under the program.</p> <p>3.5 Unit costs by type of municipal works identified, entered into the system and made available on an information system in 18 <i>intendencias</i> (ton of trash collected, construction and maintenance of roads, etc) by the end of the second year.</p>	<p>3.2.1 UDM and OPP reports</p> <p>3.2.2 Economic performance analyses submitted for each project when they end.</p> <p>3.2.3 Midterm and final evaluations.</p> <p>3.3.1 Project monitoring reports describing the beneficiaries of the investments.</p> <p>3.3.2 Midterm and final evaluations.</p> <p>3.3.3 National censuses.</p> <p>3.4.1 Project monitoring reports that include information on contracts with the private sector involved in the investment projects.</p> <p>3.4.2 Ex post evaluation of the program.</p> <p>3. 5.1 Survey reports comparing costs pre and post program in the PAIIs.</p>	